

**STATE OF CALIFORNIA
AIR RESOURCES BOARD**

In the Matter of)
)
June 2008 Discussion Draft)
Pursuant to AB 32 The California)
Global Warming Solutions Act of)
2006, Climate Change Draft)
Scoping Plan)

**Comments And Recommendations Of The
M-S-R Public Power Agency
On The June 2008 Discussion Draft Of The
Climate Change Draft Scoping Plan**

The M-S-R Public Power Agency respectfully submits its comments and recommendations regarding the June 2008 Discussion Draft Of The Climate Change Draft Scoping Plan.

Introduction

The M-S-R Public Power Agency (M-S-R) is a public entity, without taxing power, created pursuant to Sections 6500, et seq., of the Government Code of the State of California and a Joint Exercise of Powers Agreement, dated April 29, 1980 (as amended and restated on November 17, 1982) among the Modesto Irrigation District, the City of Santa Clara (dba Silicon Valley Power) and the City of Redding (herein "Member" or "Members"). M-S-R is authorized, inter alia, to acquire, construct, maintain and operate facilities for the generation and transmission of electric power and to enter into contractual agreements for the benefit of any of its Members.

The People of the State of California have declared their concerns with the emissions of those carbon-based compounds to which they attribute climate changing properties. Laws have been enacted to regulate the emissions of such compounds with the expectation of moderating or reversing climate change trends. As a publically-owned utility, M-S-R and its members have responded to the demands of the people and with due regard for the safe and reliable operation of the California power grid M-S-R has acquired renewable energy generation comprising 35% of its resource portfolio within the past three years. M-S-R is committed to increasing its renewable energy sources and mitigating the impacts of its existing thermal generation.

M-S-R is pleased to have this opportunity to comment on the June 2008 Discussion Draft of the Climate Change Draft Scoping Plan. We have provided specific comments on three areas of concern: documentation of economic effects, market manipulation of carbon credit markets, and forced divestitures of existing resources. We also join and support the comments of the California Municipal Utilities Association, Modesto Irrigation District, and the City of Redding.

Comments and Recommendations

1. Economic Effects Not Fully Documented.

The impacts of the implementation of AB32: The Global Warming Solutions Act of 2006, will reach every sector of California's economy. Estimated costs of climate change on various sectors have been provided both anecdotally and with reference to peer-reviewed studies. However, quantifications of the direct and indirect costs

of the measures proposed by ARB and the have yet to be provided in detail.¹ ARB has stated “the overall savings from improved efficiency and developing alternatives to petroleum will, on the whole, outweigh the costs².” However, little or no specific evidence has been provided to support this claim. Until ARB provides its detailed analyses, we cannot scrutinize or verify the expected costs on individual economic sectors and entities and the resultant benefits, if any. As these costs may range from inconsequential to catastrophic, this analysis must be completed as soon as possible to support rational decision-making.

Recommendation/Action: ARB to address in detail the sector, industry, and major entity specific costs and economic impacts and benefits of the Scoping Plan in Appendices G and H pursuant to AB32: The Global Warming Solutions Act of 2006 and the California Environmental Quality Act.

2. Carbon Allowance Market Manipulation

ARB has stated its intent to link its cap-and trade-program with those developed by and in the members of the Western Climate Initiative (WCI)³ and has noted the need to “ensure market security (avoid gaming)”⁴ A cap-and –trade program must be well designed if it is to provide a stable and rational market whereby emitters may purchase credits in lieu of reducing emissions from their facilities or sell credits produced by exceeding regulatory requirements in reducing their own emissions. The size of the market, or the pool of available credits, can be used to induce desired behaviors at the least cost to the society as a whole. Markets, even with the best of structures and regulatory oversight, can be manipulated – as illustrated at their

¹ The Draft Appendices to the June 2008 Draft Scoping Plan released in late July 2008 contain blank entries for Appendices G and H.

² June 2008 Draft Scoping Plan – Page ES-4

³ June 2008 Draft Scoping Plan – Page ES-3

⁴ June 2008 Draft Scoping Plan – Page 15

worst in the California Power Crises of 1999 and 2000. Even the highly regarded Federal Acid Rain Program has seen prices of Sulfur Dioxide credits swing over the past 30 months between \$1,629⁵ per ton to \$88⁶ per ton, a range of almost 2000%! If a California carbon credit market comprised 100 million tons, such a range of credit prices could vary the capital value of the annual market by nearly \$200 billion. Although volatility and speculation are natural elements of liquid markets, the design of the program and its operation and oversight need to protect the consumers of the State of California from the next Enron.

Recommendation/Action: ARB to address in the program design of a cap and trade program, if it is to be implemented, to assure:

- An adequate and transparent supply of credits sufficient to deter hoarding, but limited enough to encourage conservation and reduction of emissions.
- Market liquidity and transparency of credit trading through an open-access trading platform accessible to public oversight.
- The use of standardized credits that are tradable in future WCI or Federal cap-and-trade markets.
- Market limitations and capture of wind-fall profits to constrain costs and reduce wanton speculation.

3. Other Measures Under Evaluation (Divestiture of Coal-Based Generation)

ARB has proposed consideration of a “Coal Emission Reduction Standard,” specifically “. . . requiring electric service providers to divest or otherwise mitigate

⁵ December 9, 2005, Settlement Price per Evolution Markets, Inc.

⁶ July 15, 2008, Settlement Price per Evolution Markets, Inc.

portions of existing investments in coal-based generation.”⁷ M-S-R as a fee owner of an interest in the coal-fired San Juan Generating Station located near Farmington, New Mexico, would be impacted by such a requirement. To the extent permitted by the restrictions enacted through SB1368 prohibiting new investment in base-load generation which does not meet an Emissions Performance Standard, M-S-R is actively exploring ways to reduce the carbon foot-print of its ownership of the San Juan Generating Station. Efficiency improvement projects reduce the consumption of coal and concomitantly reduce the emission of carbon compounds. A solar thermal integration project under consideration would add 50 MW of solar energy to the output of the San Juan Generating station and correspondingly reduce coal consumption. Sequestration technologies may become physically and economically viable in the future. M-S-R believes such projects help mitigate the impacts of coal-based generation.

M-S-R and its California ratepayers have a \$400 million investment in the San Juan Generating Station and its related transmission, and M-S-R has a fiduciary duty to its bondholders and ratepayers to protect those investments over the respective lives of those facilities. Furthermore, if those investments are stranded, impaired or taken, M-S-R would have a legal requirement to remediate (redeem) its bonds under stringent timelines specified by contract and US Treasury regulations. Unlike those entities which have power purchase contracts with out-of-state coal-based generation and whose obligations may end with the cessation of electricity deliveries, M-S-R is an owner of the facility and has obligations which survive the termination of electricity generation activities⁸.

A forced divestiture of M-S-R’s interest by action of the people of the State of California in the San Juan Generating Station would not only subject M-S-R to a

⁷ June 2008 Draft Scoping Plan – Page 39 and Appendix C-78

⁸ Within the San Juan Generating Station, the City of Anaheim and the Southern California Public Power Authority are also owners and similarly situated as M-S-R.

taking of its San Juan Generating Station asset, but subject it to the vagaries of the market for replacement power. Although M-S-R has and will continue to invest in renewable and carbon-free resources, the reliable operation of the electric system relies on base-load and dispatchable generation to supplant those non-dispatchable resources. The power produced by the San Juan Generating Station would have to be replaced in-kind, at an unknown or speculative expense, with a base-load resource which may still have a significant carbon-footprint, resulting in dubious, if any, benefits to the people of the State of California.

Facilities such as the San Juan Generating Station will eventually be retired when they are no longer capable of economically supplying power to consumers. When regulatory changes accelerate that natural progression, costs are incurred and it is the regulator's responsibility to ensure that the effected owners are compensated and the benefits to society are commensurate. Although ARB has proposed an initial assessment of such costs and benefits, M-S-R is concerned that this analysis does not adequately capture the actual impacts on M-S-R and other similarly situated entities. M-S-R will provide additional information as appropriate.

The Carbon Fees ARB has proposed to impose on electricity imported into the State of California⁹ could provide the appropriate degree of economic incentive to address the carbon content of imported electricity. If the owner of a facility located outside of California chooses not to import electricity into California, the carbon emissions of that facility would be regulated under local authority, based on State, Regional (WCI), or Federal regimes. Exercising a taking of such a facility by requiring divestiture or otherwise stranding that asset would harm California ratepayers by depriving them of the economic value of that facility which may very well subsidize the production of zero-carbon energy as is the case with M-S-R. Furthermore, the

⁹ "Emission fees for California-bound electricity that is generated by power plants outside the state would need to be assessed on firms that deliver electricity to the California power grid." Draft Scoping Plan - Page 42

citizens of California would have to pay reasonable compensation to the owners of the property so taken, at significant costs to be defined by the Courts. Avoiding such a divestiture requirement would also negate any concerns regarding extra-territorial regulation. Just as the people of the United States can not regulate working conditions in a foreign sweat-shop, they certainly can tax or regulate the import of products so produced. Similarly California can tax the carbon content of electricity imported into the State as proposed above until such time as Regional or Federal Regulatory schemes become effective. Therefore, the goal of reducing the carbon content of electricity consumed in California can be met without extending regulation beyond the borders of the state.

Recommendation/Action: ARB to delete the proposed additional measure to require the divestiture of coal-based generation and ensure that carbon fees on the import of electricity are set at levels which produce net benefits to the people of the State of California until such time as those fees are superseded by regional (WCI) or national regulation offering equivalent benefits.

Respectfully submitted,

A handwritten signature in black ink, appearing to read 'M. R. Hopper', with a long, sweeping horizontal line extending to the right.

Martin R. Hopper
General Manager
M-S-R Public Power Agency